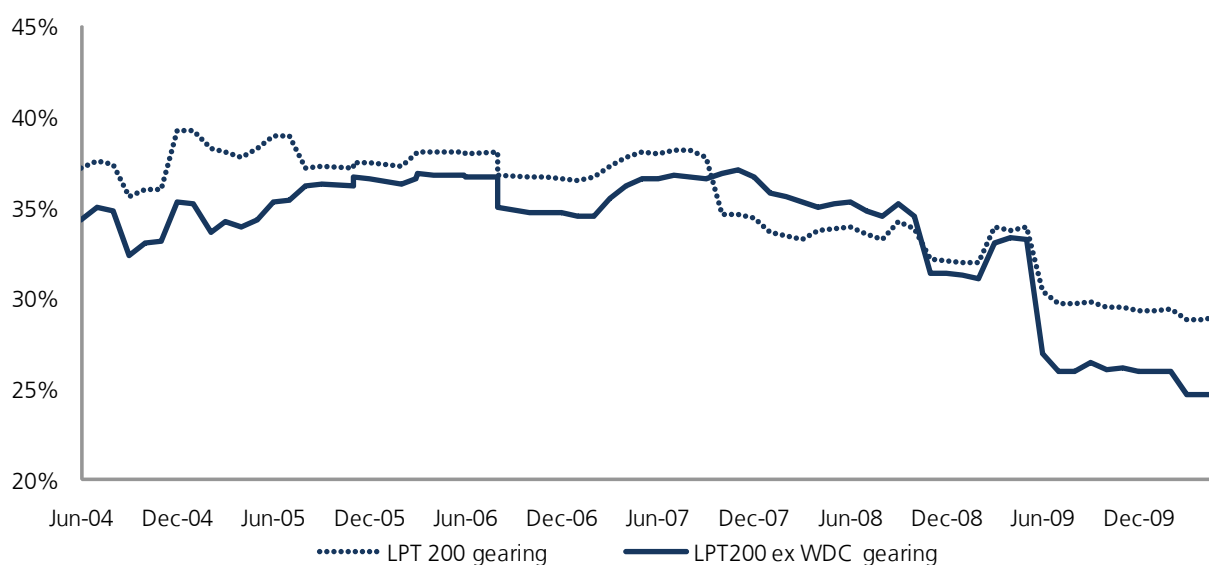


Australian Real Estate Investment Trusts - worth another look?

Throughout the global financial crisis, the Real Estate Investment Trust sector was one of the hardest hit, with the market fearful that overgeared REITs would not be able to refinance their debt obligations and subsequently become insolvent. Comparisons were being made to the early 1990's, where the banks were forcing distressed listed property owners to sell into a weak commercial property market, further pressuring solvency.

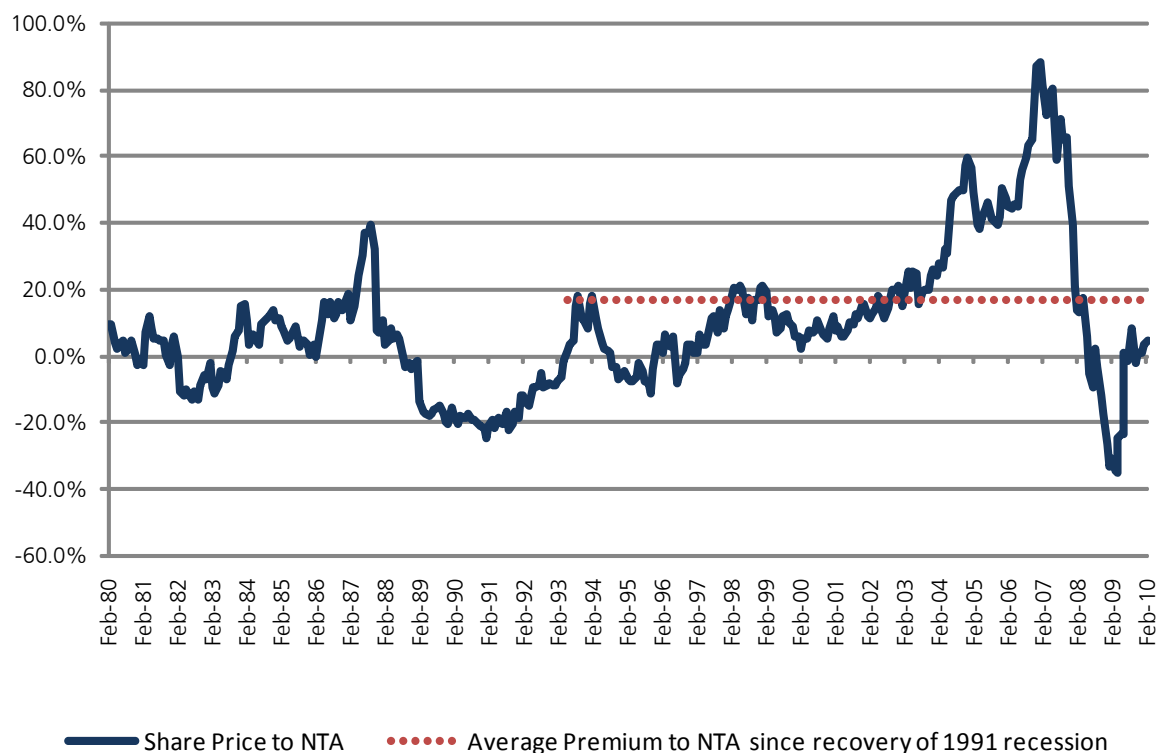
Over the past twelve months, Australian REITs have raised ~\$18bn in discounted equity capital; some at prices 30% to 40% below the prevailing share price. The recapitalised balance sheets of Australian REITs are now in a much stronger position as seen in the chart below.



Source: UBS

Property fundamentals have also improved significantly. Commercial property agent feedback regarding transactions in the marketplace have confirmed that the generous rental terms offered by property owners 12 months ago have been reduced as leasing demand improves, resulting in attractive rental yields of ~7-8%.

Market fears of 'another 1991' did not eventuate, with repeated rounds of forced selling avoided. As a result, capitalisation rates for commercial property transactions did not expand significantly, and in fact, are now beginning to contract. This bodes well for expected improvements in revaluations and higher REIT Net Tangible Asset (NTA) measures. The chart below illustrates the extent to which NTAs accelerated well above valuations through the latter half of the decade, as well as the savagery of the devaluation through the financial crisis.



Source: UBS data, Ausbil

If you consider that the market is current only marginally priced above NTA, and that NTAs are likely to improve, REIT share price valuations are starting to appear compelling.

With property fundamentals continuing to improve, we are increasingly interested in the Mid Cap area of the Australian REIT's market where share prices are trading at a 10-15% discount to NTA. Key areas of opportunities are emerging in:

- Real Estate companies with the potential for development earnings
- The retail property sector, due to improving consumer confidence conditions and
- The office property sector due to the improving domestic economic environment, improving business confidence and the employment market.

The REIT sector has recovered somewhat from the low in March 2009, returning 27.9% over the year to 30 April 2010 - a strong number in absolute terms, but relatively less than the overall market. Despite this recovery, market expectations are still muted (we would argue too conservative), with consensus EPS growth for the 2011 financial year at just 3.4% for the sector. Priced on 12.8x FY11 earnings, the Australian REIT market certainly appears worthy of another look.